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Influence the capital structure on the cost of capital and enterprise value in multinationals

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Abstract. The main problems identified in determination of capital structure are referred to identifying the source of relevant funds, evaluation of risks generated by using some funds and their costs in order to ensure the autonomy of the enterprise. The objective of any company is to achieve optimal capital structure, which is approached by minimizing average cost of capital and maximizing the market value of the company. Thus, this paper aims to study the influence of capital structure on the cost of capital and enterprise value, in the case of two multinational companies, in order to identify optimal financial structures, and the differences between them.

Keywords: financial structure, leverage, multinational corporations, weighted average cost of capital, enterprise value, taxation

JEL Code: G32, G31, F23, H25

1 Introduction

Optimal capital structure is approached in terms of cost of capital used by the company. Starting from the idea that factors with influence on the cost of capital is capital structure and the cost of each element of capital, we can say that by changing of this two influencing factors can be modified the weighted average cost of capital, for the purposes of minimizing or maximizing, and hence, this change will take effect on the enterprise value.

In the area of concerns about cost of capital and financial structure can be identified two theories with very different content and application: *theory of capital cost dependent of leverage* and *theory of capital cost independent of leverage*.

Theory of capital cost dependent of leverage takes account of lower cost of debt, assuming that under normal conditions, the cost of debt is considered less than the cost of equity in terms of risks. As the cost of debt is considered lower than cost of equity, debt growth has a positive impact on company profitability. Also, proponents of this theory considers that use of a significant indebtedness does not change the cost of equity and the upward trend in the share of debt in total financing sources will lead to a decrease in the weighted average cost of capital. Only above a certain level of indebtedness, considered with standard risk, the weighted average cost of capital begins to rise, accordingly with increased risks faced by over-indebted company. It follows that there exists a point or range of the

correlation between equity - loans, where the average cost of capital used is minimal and this point corresponding to an optimal financial structure.

Theory of capital cost independent of leverage, opposed to previous theory, supports independence of weighted average cost of capital to company indebtedness, accordingly with model proposed by Modigliani and Miller (Modigliani, F. and Miller, M., 1958). The consequence of this fact is materialized in the *absence of an optimal financial structure*, since the weighted average cost of capital remains constant. This theory is disputed in terms of its unrealistic assumptions, and its validity is difficult to be tested, but maybe possible in isolated cases.

In 1963, taking model demonstration in the presence of tax, Modigliani and Miller (Modigliani, F. and Miller, M., 1963) show that financial structure influences the company value, the value of indebtedness company being higher than that of an non-indebtedness company, and increasing the share of debts in the capital structure will lead to decreasing in the weighted average cost of capital in the context of interest deductibility from taxable profits.

Also, authors concluded that consideration of profit tax *privileges indebtedness in relation to equity financing* because interest costs are deducted from taxable income. This amount will be received by company creditors without being subject to tax, but dividends are not deducted from the tax base, shareholders cashing them only after paying income tax. Leverage increases the return on equity, having double interpretation: on the one hand indicates increasing of business performance and, on the other hand, is a premise for increasing the cost of equity requested by shareholders of an indebted company.

Modigliani and Miller show that return on equity for levered company, higher than return on equity for un-levered company, will be determined by adding return on equity for un-levered company to leverage effect and tax influence. Leverage effect occurs only if return on assets is higher than the interest rate before tax.

Related to the impact of debts and taxation on the value of weighted average cost of capital and the enterprise value, the Modigliani and Miller conclude was that financial structure is not neutral in tax hypothesis because interest is deductible in calculating taxable income, financial structure influences the value of enterprise, the leverage enabling the increase in enterprise value (Onica, M.C. and Domniteanu, L., 2011).

This paper presents a study of financial structure influence on the cost of capital and enterprise value for the two producers of vehicles: Automobile Dacia and Kia Motors for the period 2008-2011, in order to test dependence of theories related to capital cost dependence of debts, in terms of taxation and under the impact of the financial crisis.

Automobile Dacia[1], the first and the largest Romanian vehicle manufacturer, was founded in 1966 with the creation of Vehicle Plant in Mioveni. In 1999, Renault bought 51% of the shares in the privatization process, and currently holds 99.43% of the capital of Dacia. Renault's investments to Dacia, including the completion of an extensive modernization process by the end of 2008 amounted to over 1.2 billion euros.

Kia Motors Company[2] has pursued globalization and strived to raise their profile on the world stage for the last decade. Expansion started with the Chinese plant in 2002, then they built a manufacturing facility in Slovakia in 2006 and, in November 2009, began production of their latest plant in Georgia,

[1] www.daciagroup.com .
[2] www.kiamotors.com

USA. They effectively completed their global network of localized development, production, sales and after-sales service in the three major markets of China, Europe and the USA in less than ten years.

For this study were selected this two companies since the different evolutions of financial structure in the period 2008-2011: one has small fluctuations, below 1%, in the weighted average cost of capital, but important fluctuations of enterprise value, and the other has increasing values of the weighted average cost of capital and, at the same time, major fluctuations of enterprise value. The paper is divided into four sections: the first section presents a literature review on studies conducted on the financial structure for multinational companies, the second section aims to analyze the evolution of the financial structure of the two companies, the third section presents the effect of leverage and taxation on financial structure and enterprise value, and the last section presents the determination of weighted average cost of capital and its influence on the enterprise value.

2 Literature review

Financial structure and cost of capital in the multinational companies had been studied for a long time, both theoretical and empirical, and also, comparative with national companies. Thus, Shapiro A.C. (Shapiro, A.C., 1978) provides a comprehensive approach of the cost of capital, extending the weighted cost of capital concept to the multinational corporations. His analyze is based on: national or multinational financial structure norms; the role of parent company guarantees; the costing of various fund sources particularly when exchange risk is present; the impact of tax and regulatory factors; risk and diversification; and joint ventures.

Desai M.A. and colleges analyze the capital structures of foreign affiliates and internal capital markets of multinational companies. He found that multinational affiliates are financed with less external debt in countries with underdeveloped capital markets or weak creditor rights, reflecting significantly higher local borrowing costs. Instrumental variable analysis indicates that greater borrowing from parent companies substitutes for three-quarters of reduced external borrowing induced by capital market conditions. They stated that multinational corporations appear to employ internal capital markets opportunistically to overcome imperfections in external capital markets (Desai, M.A. *et al*., 2000).

Singh, K. & Hodder, J.E. (2000) studied multinational capital structure decisions when firms have varying degrees of financial flexibility for shifting income and/or tax shields between subsidiaries. They found that: firms can use leverage to dramatically reduce negative valuation effects from operating in a high-tax country; financial flexibility is a key determinant of optimal capital structure, acting as both a substitute and a complement for leverage; multinational firms derive a synergistic effect from financial flexibility, which can enhance their value beyond that for a single-country firm from a low-tax jurisdiction; and optimal capital structure typically differs substantially across subsidiaries, with each having positions in multiple currencies.

Other authors investigate whether there are systematic differences in the capital structure formation of local companies and subsidiaries of multinational corporations operating in the Baltic States over the period from 2000 to 2008. They found local companies to be more leveraged than multinational corporations, mainly explained by use of intra group equity financing. Also, multinational companies appeared to have had better access to external finance, resulting in their competitive advantage over local companies, especially in periods characterized by significant credit constraints (Avarmaa, M. *et al.*, 2011).

Yonezawa Y. and colleges compared and analyzed capital structure strategies of foreign affiliates among Japanese and U.S. multinational firms in terms of efficiency of the internal capital markets.

Their research revealed that Japanese multinationals allocate the fund efficiently by utilizing internal capital markets to the same extent as U.S. counterpart do. Also, they heavily rely on financing from their parent companies and Japanese banks, and diversification of the source of fund seems to be insufficient (Yonezawa, Y. et al., 2006).

Akhtar, S. and Oliver, B. started from the previous studies on US multinationals that often report lower leverage for multinationals relative to domestic corporations, while studies on samples of French and Canadian multinationals find the theoretical relation. They extended the research to Japanese multinationals, finding that Japanese multinationals have significantly lower leverage than domestic firms (Akhtar, S. and Oliver, B., 2005).

Chkir and Cosset examines the relationship between the capital structure of multinational companies and their diversification strategy. Both the international market (multi-country operations) and the product (multi-industry operations) dimension of diversification are integrated into the analysis and a switching of regression regimes methodology is employed that accounts for the bi-dimensional nature of the diversification strategy pursued by multinational corporations. The results suggest that: leverage increases with both international and product diversification; the combination of both types of diversification leads to lower levels of bankruptcy risk; the role of the determinants of MNC capital structure varies with the diversification strategy, there seem to be common determinants; profitability and bankruptcy risks are negatively related to the debt ratio of multinational companies (Chkir, I.E. and Cosset, J.-C., 2001).

Hauer, A. & Runkel, M., (2008) sets up a model where two countries compete for internationally mobile firms through statutory tax rates and thin capitalization rules that limit the tax-deductibility of internal debt flows within multinational enterprises. More over, both multinational and domestic firms can respond to a higher domestic tax rate by increasing the level of external debt finance. For the case of identical countries they show that tax competition leads to inefficiently low tax rates and inefficiently lax thin capitalization rules. If countries differ substantially in the number of domestic firms, then a coordination of thin capitalization rules may reduce welfare in the country with the larger domestic tax base. Also, Panteghini, P.M. (2006) studied the relationship between debt policies of multinational companies and governments' tax strategies. He showed in the first part that the ability to shift income from high- to low-tax countries affects multinational companies' financial choices.

Kornbluth J. S.H. and Vinso J.D. stated that the financial manager of the multinational company is faced with various tax structures, changing exchange rates, barriers to capital flows, and the possibility of financial market segmentation. They are considering that the main problems are: determining an optimal capital structure; identifying the sources of the relevant funds; evaluating the risk that the value of these flows will change owing to changing exchange rates (Kornbluth, J. S.H. and Vinso, J.D., 1982).

Hoffjan A. and Rosmann M. give an overview of the special issue features of funding foreign subsidiaries. They discussed about the possibility of funding by equity capital or borrowed capital in the form of loans and trade accounts payable (Hoffjan, A. and Rosmann, M., 2002).

If it is assumed that the goal of management is to maximize the value of the company, it can be shown that it is necessary to obtain financing at the lowest cost. For a multinational company which has access to funds in many countries, this goal should be consistent with minimizing the cost of capital for the consolidated multinational companies (Kornbluth, J. S.H. and Vinso, J.D., 1982).

3 Analysis of financial structure evolutions

According to opinions expressed by Piaget, the structure is a system of transformation that as the system behaves existence of laws (as opposed to properties of the system components) that is conserved or developed through its own transformation game. A structure has three attributes: *the totality, of transformations and self-adjusting* (Piaget, J., 1973). Adapting these three qualities in financial theory, we can say that *totality* (the set of elements) is represented by the funds available to an enterprise (own or borrowed), *transformations* are recorded in the cost of funding sources, and the level of risk that is subject company and the *self-adjusting* is expressed in the possibility of changing the structure of funds (Tudose, MB, 2006).

Overall funds available to companies Automobile Dacia and KIA Motors in the period 2008-2011 is presented in Tables 1 and 2, and the evolution of the financial structure, in percentage, is shown in Figure 1.

Table 1. Capital structure to Automobile Dacia in the period 2008-2011 (mil. euros)

Indicator	2008	2009	2010	2011
Equity	2.961	3.154	3.315	3.534
Provisions	128	130	124	106
Revenue in advance	42	94	71	54
Own funds	**3.131**	**3.378**	**3.510**	**3.694**
Debts to be paid within a period of more than one year, of which:	0	0	158	157
Financial liabilities:	0	0	158	157
Debts to be paid within a period of less than one year, of which:	1.126	1.508	1.881	2.243
Financial liabilities:	169	226	282	336
Total debts	**1.126**	**1.508**	**2.039**	**2.400**
Total liabilities	**4.257**	**4.886**	**5.549**	**6.094**

Source: Data from Financial statements of Automobile Dacia in the period 2008-2011

At Automobile Dacia own funds include provisions and revenue in advance, and total liabilities include short, medium and long term debts. Throughout the period under review, Automobile Dacia showed a decreasing share of own funds, between 60.62% and 73.55%, which means that more than half of financial resources received by the company during this period come from internal sources. This was due to the increase in own funds (with percentages ranging between 3.91% and 7.89%) at a rate lower than increased total debts (with percentages ranging from 17.70% to 35.21%).

As we mentioned, total debts had an upward trend, driven mainly by increasing short-term debts, but also borrowing on medium and long term in 2010 of 158 million. Overall, all funds used by Automobile Dacia in the period 2008-2011 showed an upward trend, with increases ranging between 9.82% and 14.78%, increase mainly due to debts developments.

Table 2. Capital structure to KIA Motors in the period 2008-2011 (mil. euros)

Indicator	2008	2009	2010	2011
Equity	367,557	446,680	682,841	901,023
Own funds	**367,557**	**446,680**	**682,841**	**901,023**

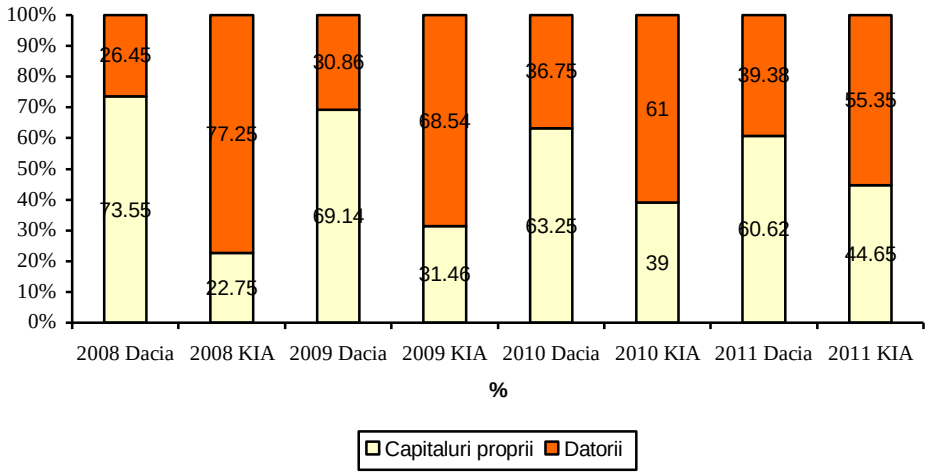
Debts to be paid within a period of more than one year, of which:	383,456	301,289	293,142	355,051
Financial liabilities:	292,089	251,983	195,825	202,466
Debts to be paid within a period of less than one year, of which:	864,810	671,949	774,753	761,779
Financial liabilities:	487,130	347,267	238,885	207,024
Total debts	**1,248,266**	**973,238**	**1,067,895**	**1,116,830**
Total liabilities	**1,615,823**	**1,419,918**	**1,750,736**	**2,017,853**

Source: Data from Financial statements of KIA Motors in the period 2008-2011

Throughout the period under review, KIA Motors has registered an increasing share of equity between 22.75% and 44.65%, which means that more than half of financial resources received by the company during the period come from external sources (bonds, banking loans and financial leases). This was due to the increase in equity (with percentages ranging between 21.53% and 52.87%) while total debt had a fluctuating trend: decrease of 22.03% in 2009 compared to 2008 and increase of 9.73% and 4.58% thereafter.

Overall used funds by KIA Motors in the period 2008-2011 recorded, as total debts, a fluctuating evolution: decrease of 12.12% in 2009 compared to 2008 and increase of 23.30% and 15.26% at the end of the period under review, which indicates that the debts that have the highest share in total liabilities, dictate the evolution of all company resources.

Figure 1. Capital structure evolution in period 2008-2011 (%)



Source: Realized by the author.

From Figure 1 it is observed that in the period under review, the Automobile Dacia equity share is reduced compared to debts and to the KIA Motors the evolution is reversed. These *transformations* are generated by developments in cost funding sources, which is the weighted average cost of capital, but probably at the level of risks faced by companies.

4 Determination of weighted average cost of capital

As we mentioned, economists Modigliani and Miller (1958) have founded the relationship between weighted average cost of capital and financing structure in two ways: in the context of the absence of

taxation, but also in its presence. Corresponding to funding sources to which appeals an enterprise can be determined specific costs related to categories of capital that contributes to good achievement of the object of activity. At the company level there are two types of capital costs: cost of equity and cost of debt.

Equity cost of a company is given by the rate of return expected by shareholders. The cost of equity for company, in terms of tax factor, represents the requested profitability, expected by those who hold own funds, respectively shareholders or associates, or that minimum rate of return that inciting on potential shareholder to buy a share and determine actual shareholder to preserve the financial security (Brezeanu, P., 1999).

Cost of debts corresponds to minimum rate of return that lenders require it for appropriate risk posed by a company (Onica, M.C., 2009). For lenders, the cost of debt is based on earned interest and debt repayment. Creditors are subject to a less important risk compared with those who contribute to their own funds, and thus, require less high profitability, therefore, under normal conditions, the cost of debt should be lower than the cost of equity.

Once established individual costs of all sources of funding, the company may determine a *weighted average cost of capital* from the share of each source. Weighted average cost of capital calculation is done in three stages (Tudose, M.B., 2006):

a. identifying of all funding sources available to a company and determination of market value, which is more important than book value of each element of capital;

b. determination the cost of each type of capital used;

c. calculation of a weighted average cost depending on the proportion of each financial source in the overall capital of the company, as follows: $WACC = \frac{E}{E+D} * K_E + \frac{D}{E+D} * K_D * (1-t)$, where:

WACC = weighted average cost of capital;

K_E = equity cost;

K_D =cost of debts;

t = profit tax;

$\frac{E}{E+D}$ = share of equity in total liabilities;

$\frac{D}{E+D}$ = share of debts in total liabilities.

The options of the company related to financing is based on a number of variables, including taxation that can play an important role through its influence on the cost of each resource and the effect that a decision or another may have on the company's taxable income. In general, we can say that under normal economic environment, companies favours the use of foreign resources on long term towards increases of capital through new contributions of shareholders, due to leverage effect on the benefits that will remain available to shareholders (Istrate, C., 2011).

Return on equity, assuming the existence of taxation, relationship allowed to American economists, Modigliani and Miller, which represents the cost of equity (K_E) is determined as follows:

$K_E = R_f = R_0 + (R_0 - R_D) \times \frac{D}{E} * (1-t)$, where:

R_f = cost of equity in presence of debts, that is return on equity in terms of taxation;

R_0 = cost of equity in absence of debts that is return on assets in the case of $\frac{D}{E} = 0$;

R_D = cost of debts or return requested by creditors;

D = total debts;

E = equity;

t = tax rate;

$(R_0 - R_D)$ = financial leverage;

$\frac{D}{CP}$ = leverage arm.

The overall debt level involves changing in return on equity, either to increase or decrease its, as return on assets is above or below the average cost of debt. This effect is amplified by the lever arm as the share of debt in funding source is higher.

This relationship highlights the effect of taxation on return on equity. Thus, if the entity is profitable, taxation (interest deductibility and profit tax) reduces leverage effect. Otherwise, generally, the tax does not affect the return on equity. Effects of taxation in terms of debt are completed with another component of the tax burden, namely the tax on dividends, which the company must pay when remunerate equity. The tax on dividends may be considered as an additional element and deterrent of the cost of equity.

Weighted average cost of capital is determined for the analyzed period in the case of those 2 companies, as we shown in Tables 3 and 4.

Table 3. Weighted average cost of capital to Automobile Dacia in the period 2008-2011

Indicator	2008	2009	2010	2011
Net profit[3]	245	246	324	300
Total assets	4.257	4.886	5.549	6.094
Cost of equity in absence of debts (R_0)	0,0575	0,0503	0,0583	0,0493
Cost of debts [4] (R_D)	**0,1597**	**0,0840**	**0,0636**	**0,0609**
Financial leverage $(R_0 - R_D)$	-0,1022	-0,0337	-0,0053	-0,0116
Total debts (D)	1.126	1.508	2.039	2.400
Equity (E)	3.131	3.378	3.510	3.694
Leverage arm ($\frac{D}{E}$)	0,3596	0,4464	0,5809	0,6497
Cost of equity (K_E)	**0,0266**	**0,0377**	**0,0557**	**0,0429**

[3] Net profit was adjusted for an un-levered company by eliminating interest costs in determining taxable profit. This note is available for both companies.

[4] The interest rate was calculated in a simplified manner, as a ratio between interest costs and total financial liabilities on short, medium and long term. Also, this note is available for both companies.

Share of equity in total liabilities $\frac{E}{E+D}$	0,7355	0,6914	0,6325	0,6062
Share of debts in total liabilities $\frac{D}{E+D}$	0,2645	0,3086	0,3675	0,3938
Weighted average cost of capital (WACC)	**0,0550**	**0,0479**	**0,0549**	**0,0462**

Source: Realized by the author

In the period under review, return on assets was lower than interest rate, which shows the existence of a negative leverage, leading to diminishing of return on equity against return on assets, as leverage increases. Thus, leverage effect plays a negative role on expected return to shareholders, and this adverse effect of debt over return on equity adds to economic risk a specific dimension, namely financial risk (Vintilă, G., 2000). The cost of debts is the interest rate paid on loans. In the period under review, the company has benefited from interest rates decreasing from 15.97% in 2008 to 6.09% in 2011, which are correlated with average annual interest rates on loans for businesses, published by the National Bank of Romania.

The size of weighted average cost of capital depends on the proportion of each component of the total funds and their cost individually. Weighted average cost of capital is a weighted sum of cost of shares and debt costs. Minimizing the cost of capital is a condition for business survival and a support for their development. Financial management task is to structure the capital resources to meet the funding needs at minimal cost. In this framework, the rule of financial prudence should be respected: long-term needs should be covered by permanent resources and short-term needs should be covered by current resources.

Average cost of capital is a minimum level of company return. From Table 3 we can see fluctuating trend of weighted average cost of capital at Automobile Dacia, varying between 4.62% and 5.50%, similar to the cost of equity evolution. Optimal capital structure is obtained in the year 2011, when the weighted average cost of capital is lower. The conclusion of the analysis on Automobile Dacia is that as leverage increases, the weighted average cost of capital is reduced even in a negative leverage, due to the effect of taxation.

Table 4. Weighted average cost of capital to KIA Motors in the period 2008-2011

Indicator	2008	2009	2010	2011
Net profit	34.654	70.885	148.671	196.501
Total assets	1,615,823	1,419,918	1,750,736	2,017,853
Cost of equity in absence of debts (R_0)	0.0214	0.0499	0.0849	0.0974
Cost of debts (R_D)	**0.0531**	**0.0557**	**0.0531**	**0.0522**
Financial leverage $(R_0 - R_D)$	-0.0316	-0.0057	0.0319	0.0452
Total debts (D)	1,248,266	973,238	1,067,895	1,116,830
Equity (E)	367,557	446,680	682,841	901,023
Leverage arm ($\frac{D}{E}$)	3.3961	2.1788	1.5639	1.2395
Cost of equity (K_E)	**-0.0859**	**0.0374**	**0.1347**	**0.1534**
Share of equity in total liabilities $\frac{E}{E+D}$	0.2275	0.3146	0.3900	0.4465

Share of debts in total liabilities $\frac{D}{E+D}$	0.7725	0.6854	0.6100	0.5535
Weighted average cost of capital (WACC)	**0.0215**	**0.0499**	**0.0849**	**0.0974**

Source: Realized by the author

If in the case of KIA Motors, return on assets was lower than interest rate, in period 2008-2009, which highlights the existence of a negative leverage, leading to decreasing of return on equity toward return on assets, when the leverage is high. Leverage effect has a negative role on the expected profitability of shareholders, under a highly leveraged, return on equity being even negative in 2008.

In the period 2010-2011, financial leverage is positive (return on equity is greater than the return on assets, which is higher than the interest rate). Leverage effect has a positive role on return on equity, in terms of level of debt decreased. Cost of debt remains almost constant over the period under review, this fluctuating within a very small interval, between 5.22% and 5.57%. From Table 4 we can see an increasing trend of weighted average cost of capital at KIA Motors, varying between 2.15% and 9.74%, similar to the cost of equity evolution, from -8.59% to 15.34%.

Optimal capital structure is obtained in 2009, when the weighted average cost of capital is lower, under the terms of profit (from Table 4 we can observe that the WACC is the smallest in 2008, of 2.15%, but this year ended with losses). The conclusion of the analysis achieved on KIA Motors is that as leverage decreases, the weighted average cost of capital increases, even in a positive or negative leverage, due to reduction the positive effect of taxation by lowering the share of debt.

If to the Automobile Dacia there is a higher cost of debt than equity, at KIA Motors the same situation is found only in 2008-2009, then in 2010-2011, the cost of capital is higher than the debt, that remains approximately constant.

By comparative analysis of the two companies, there is a different vision from European to Asian companies. At European company, is used mostly equity, which have a lower cost than the debt so that the optimal capital structure is obtained when the equity share is about 60%. This shows the disparity in financial markets and the companies tend to finance from its own resources preponderantly.

In the Asian company is used most debts, which have a lower cost than equity, consistent with the financial theory, in 2010-2011. For the first two years, the situation is similar to that of the European company. However, optimal capital structure is obtained in 2009 when the cost of debt is higher than the cost of equity (but very similar values) and the debt ratio is about 70%, which shows a predominant tendency of using leverage. As the debt ratio is reduced, the weighted average cost of capital increases in terns of taxation, due to increased cost of equity and reduction of tax benefits.

5 The effect of leverage and taxation on financial structure and enterprise value

Enterprise market value can be determined by discounting operational cash flows generated by the enterprise asset portfolio. It has, in return, on the one hand, the market value of securities owned by shareholders and, on the other hand, the market value of debts. The value of ownership securities and claims is based on cash-flows that shareholders and creditors receive them. From their point of view, these securities are investments to which they expect a certain return, depending, in particular, of the economy situation, the risk set out, taxation and their attitude towards risk.

Enterprise value depends on both the proportions of each source of financing participation in total funding and the costs involved in these resources. Besides of capital cost longer acts and other

constraints, such as (Tudose, M.B., 2006): access to capital markets, the financial position of the company, the financial interests of managers and employees.

If the company is listed to stock exchange, a lack of profitability involves sale of shares and a decrease in exchange rates to the point where the required shareholders return is satisfied. Most often, this law is verified in the case of a small company, as follows: *if the return is not sufficient to remunerate own funds, there will be a loss of wealth for major shareholder and loss of business on long term.*

The effect of taxation is not neutral, as far as companies can deduct from their taxable income the interest paid on the borrowed amounts. Therefore, even if the interest rates at which individuals and businesses can access are identical, there is an advantage for a debtor company because through loans, the shareholder may receive a tax saving related to financial expenditure; hence we can say that: *tax deductibility of financial expenses favours indebtedness* (Brezeanu, P., 1999). Thus, given the general rules imposed by tax law that allows only companies to deduct interest on loans from their taxable income, it appears that the amount of levered firm is greater than the value of an enterprise un-levered. The value of a levered company is equal to the value of a company without debts plus the present value of tax savings associated to financial costs.

It is obvious that this equality is maintained unless only companies benefit from the tax savings. If individuals could deduct from their taxable income the interest paid on amounts borrowed and, in addition, they would be taxed at the same marginal rate as businesses, the advantage of debt would disappear. The fact that the company is a debtor rather than shareholder, there would be of no interest, because the shareholder would receive the same tax savings of financial expenditure as enterprises. In this case, it concludes that the value of the company is independent of its financial structure.

In fact, contrary to the situation of enterprises, individuals can't generally deduct from their taxable income the interest on loans. Therefore, that value of levered enterprise is greater than the value of a company without debts; it might be think that will be reached the situation when all companies will want to be indebted, to take full advantage of the tax benefits relating to indebtedness. But, in reality, the situation is quite different, because debt becomes risky when the leverage ratio exceeds a certain level.

Enterprises value, indebted in our case (Table 5 and 6), is determined by summing the un-levered enterprise value with tax savings generated by debt. Levered enterprise value (V_L) is determined as follows (Bărbuţă-Mişu, N., 2009): $V_L = V_0 + E_{imp} = \frac{EBIT \times (1-t)}{K_{CP}} + \frac{t \times R_D \times D}{K_D}$, where:

V_0 = non-levered enterprise value;

R_D = K_D = cost of debt;

E_{imp} = tax savings from using debts;

EBIT = profit before interest and taxes (exploitation profit).

Table 5. *Enterprise value of Automobile Dacia in the period 2008-2011*

Indicator	**2008**	**2009**	**2010**	**2011**
EBIT	241	277	322	390
$\frac{EBIT \times (1-t)}{K_{CP}}$	7.611	6.169	4.855	7.635

Total debts (D)	1.126	1.508	2.039	2.400
E_{imp}	180	241	326	384
V_L	7.791	6.410	5.181	8.019

Source: Realized by the author

Table 6. *Enterprise value of KIA Motors in the period 2008-2011*

Indicator	**2008**	**2009**	**2010**	**2011**
EBIT	42	71,149	165,913	235,108
$\frac{EBIT \times (1-t)}{K_{CP}}$	-410	1,598,005	1,034,645	1,287,421
Total debts (D)	41,347	33,350	23,067	21,357
E_{imp}	6,616	5,336	3,691	3,417
V_L	6,205	1,603,341	1,038,336	1,290,838

Source: Realized by the author

There is a pronounced variation in the value of the two companies during the period 2008-2011. Although EBIT follows a path upward from both companies, the decisive factor was the cost of equity of the company.

Cost of equity uptrend by 2010 in Automobile Dacia, and influenced the business value downwards. In 2011, along with the equity cost decreasing, fell and weighted average cost of capital. Enterprise value was also a fluctuating trend, and we could say that because of the crisis; and we can observe a recovery since 2011.

To KIA Motors, cost of equity has evolved ascending throughout time, determining gradually the weighted average cost of capital increasing. Value of the company had a fluctuating trend, increased in 2009, decreased in 2010 by 35.24% and then increased in 2011 by 24.32%.

5 Conclusions

Financial structure plays an important role in characterizing any society, after which, creditors or shareholders / associates decide equity participation or, where appropriate, the withdrawal of the company in the absence of prospects for its recovery in the economic market. Financial structure influences the economic performance of the company (Ţogoe, D., 2011).

In the case of these 2 companies analyzed, we could detach following concluding observations:

- WACC to the European company is mainly determined by the cost of equity under an indebtedness level reduced, below 50%, as is in the entire period analyzed: WACC was a fluctuating trend, as well as the company value;

- WACC to the Asian company is mainly determined by the cost of debt, under a very high level of debt, over 55% as is in the entire period analyzed: WACC was an ascending trend, while the company value was a fluctuating trend;

- in the European company is confirmed the theory of capital cost dependent by debts, while the cost of equity is lower to the cost of debts and the increase in leverage lead to the increase in WACC, since the tax benefits of debt are lower than the increase in cost of equity;

- in the Asian company, in 2010-2011 period, is confirmed the theory of capital cost dependent by debts, while the cost of equity is higher than cost of debt, and reducing in degree of debts lead to the increase in WACC, as the tax benefits of debt diminishes to greater measure than the cost of equity increases;

- to the European company, the weighted average cost of capital and maximum enterprise value is obtained for a structure of debt - equity ratio of 40% -60%, while the Asian company of 69% - 31%.

After the evolution in 2011, we could say that in the European company, if this trend continues, respectively increases the share of debts and decreases the cost of debt, in the future, weighted average cost of capital will decrease and the enterprise value will increase in terms of taxation. In the Asian company, there is a reduction of debt ratio (whose cost is relatively constant), and an increase in equity (whose cost increase); in the future, weighted average cost of capital will increase and the enterprise value will decrease in terms of taxation. But we should not overlook the fact that in the present context, there are many non-financial factors, that motivate the management representatives (Boca, DG, 2011), which may influence the value of the company.

7 References

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